Nos. 12535 - 12536

In the United States Court of Appeals for the Ninth Circuit

LOUIS RUBINO, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

CATHERINE RUBINO, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 26-41) are unreported.

JURISDICTION

These appeals involve income and victory taxes for 1943. (R. 27.) The Commissioner's notice of deficiency (R. 15-23)[1] was mailed to the taxpayer on or about

[1] At the request of counsel for the taxpayers, only the record of Louis Rubino has been printed (R. 94) so that unless otherwise indicated, record references herein will be to his case and he will be called the "taxpayer."

October 8, 1947. (R. 15.) Within 90 days thereafter, and on December 9, 1947, the taxpayer filed his petition with the Tax Court for redetermination under Section 272 of the Internal Revenue Code. (R. 4-23.) The decisions of the Tax Court that there is a deficiency in income and victory tax for the year 1943 in the amount of $1,655.27 in the case of Louis Rubino and in the amount of $1,687.29 in the case of Catherine Rubino were entered on January 19, 1950. (R. 3, 42, 43.) The case is brought to this Court by petition for review filed March 27, 1950 (R. 3, 83-89), pursuant to the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court properly sustained the Commissioner's determination that the property involved was held by taxpayer primarily for sale to customers in the ordinary course of business so that the profits from the sale of such property are taxable as ordinary income and not as capital gains under Section 117(j) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These are set out in the Appendix, *infra.*

STATEMENT

These cases were consolidated for trial and report in the Tax Court. (R. 2, 27.)

The Tax Court found the following facts with respect to the issue as to which these appeals have been taken (R. 28-32):

The taxpayers are husband and wife residing at Stockton, California. They filed separate tax returns for the years involved on the community property basis with the Collector of Internal Revenue for the First

District of California. Taxpayers' returns for 1942 were filed on April 15, 1943, under an extension of time granted by the Commissioner. During all of the years material to this proceeding the taxpayers kept their books and filed their returns on the accrual basis. Taxpayer, Louis Rubino, will hereafter be referred to as taxpayer. (R. 28.)

During the years involved taxpayer owned and operated the Alpine Mill & Lumber Company and was also engaged in the business of ranching and building homes for sale. (R. 28.)

In order to obtain materials needed for the building of houses, taxpayer filed with the Office of Production Management in February, 1942, one application for priorities for materials to be used in the construction of 49 dwelling houses and another application for priorities for materials to be used in the construction of 13 dwelling houses. Both applications were approved on April 7, 1942. In the applications taxpayer stated that the proposed total monthly rental to be charged per dwelling unit was $50 (R. 28-29.)

During the war years the National Housing Agency issued certain general orders, one of which included "III. National Housing Agency General Orders, Part 702, Title 24, Code of Federal Regulations." (R. 29.) Section 5 of that order provided as follows (R. 29-30):

> Section 5. Disposition of Private War Housing
>
> .01 Private war housing begun on or after February 10, 1943, shall be held for rental only to eligible war workers for the duration of the national emergency declared by the President on September 8, 1939, and, except for involuntary transfers, shall be disposed of only as follows:
>
> a. An occupant, after two months' occupancy, may purchase the private war housing unit oc-

cupied by him subject to NHA General Order No. 60-3.

b. A person who will not himself occupy such housing may purchase or otherwise acquire such housing at any time, in accordance with NHA General Order No. 60-3, provided the occupancy and disposition limitations applicable to such housing prior to such purchase or acquisition shall continue to be applicable to such housing after such purchase or acquisition, or

c. At any time subsequent to 60 days after completion of any such housing, the owner of such housing may petition the National Housing Agency, in accordance with NHA General Order No. 60-3, to permit such housing to be disposed of otherwise than as provided above in this subsection 5.01.

The fair average useful life of the dwellings rented by taxpayer in 1943 was 30 years. The taxpayers in their 1943 income tax returns deducted depreciation amounting to $2,141.15 in total on 30 of such dwellings which had been rented during 1943 and which were being rented at the end of that year. The deduction was not changed or adjusted by the Commissioner on audit of the returns. The taxpayers did not deduct in their income tax returns for 1942 and 1943 any amount for the depreciation of 10 dwellings which were sold during 1943 and which had been rented on an oral lease month-to-month basis. All of taxpayer's houses which he rented were rented on that basis. In addition, due to the shortage of housing, most of the homes which taxpayer rented were rented prior to completion. The depreciation allowable on the 10 dwellings amounts in total to $110.83 for the year 1942 and to $735.75 for the year 1943. (R. 30.)

During the taxable year 1943 taxpayer sold 33 dwellings. On their 1943 returns the taxpayers showed the

reported gains on 23 of such dwellings as short-term capital gains and on 10 of the dwellings as long-term capital gains. Of these 10 houses, three were constructed or completed in 1942, three in February, 1943, and four in March, 1943. The gross sales price of the 10 dwellings and the lots on which they were located was $53,465 and the realized gain by the taxpayers, after adjusting for the allowable depreciation of $110.83 and $735.75 for the taxable years 1942 and 1943, respectively, as set forth in the above paragraph, was $17,-164.11. (R. 30-31.)

In 1944 taxpayer sold 27 houses, one of which had been constructed in 1941, one in 1942, 15 in 1943, and 10 in 1944. During 1945 he sold four homes that were constructed in 1943. (R. 31.)

The sales and rentals of the houses owned by taxpayer in 1943 were handled by real estate brokers. Taxpayer previously had constructed and held homes for sale in 1940 and 1941. (R. 31.)

For the year 1943 taxpayer's receipts from the rental of real estate were $15,108.28, and after deduction of depreciation of $2,141.15 his rental income was $12,-967.13 before deductions for interest on mortgages, taxes, maintenance, overhead, real estate agents' commissions, etc. His profit on real estate sold during the same year was $35,458.25 after deduction of both direct and indirect costs. (R. 31.)

In the "Explanation of Adjustments" concerning the property which taxpayer sold in 1943 the receipts from which taxpayer has treated as taxable as capital gains, the Commissioner stated as follows (R. 31-32):

> During the taxable year 1943 you sold thirty-three houses of which three were constructed by you during the last six months of 1942 and the remaining thirty during 1943. Since these transactions were frequent and continuous, it is con-

> sidered that these houses are properly held for sale to customers in the ordinary course of your business. Accordingly, the profit realized on such sales is taxable as ordinary income.

The dwelling units involved, together with the lots, were held by taxpayer primarily for sale to customers in the ordinary course of his business. (R. 32.)

The Tax Court upheld the Commissioner's determination. (R. 34-39.)

SUMMARY OF ARGUMENT

The Tax Court properly sustained the Commissioner's determination that the homes in question were held by the taxpayer primarily for sale to customers in the ordinary course of his business and therefore the profits from sales of such homes should be treated as ordinary income and not as capital gains under Section 117(j) of the Internal Revenue Code. The Tax Court found as an ultimate fact that the property was held primarily for sale to customers in the ordinary course of business. That finding is clearly correct and there is ample evidence to sustain it. The sales were not casual but frequent and continuous, the profits realized were substantial, and in his 1942 income tax return taxpayer stated he was building homes for sale. Taxpayer's effort to prove he was engaged primarily in renting the property is not convincing. The fact that depreciation was allowable on the rented buildings is beside the point, and it is not at all inconsistent with the conclusion that the property was held primarily for sale to customers in the ordinary course of business. In the circumstances there is no adequate basis for disturbing the decision of the Tax Court here, and it should therefore be affirmed.

ARGUMENT

The Tax Court Correctly Sustained the Commissioner's Determination That the Profits Here Involved Are Taxable as Ordinary Income

The fundamental question presented on these appeals is whether the gains from the sales here involved are taxable as ordinary income, as determined by the Commissioner and held by the Tax Court; or whether such gains should be treated as capital gains under Section 117(j) of the Internal Revenue Code (Appendix, *infra*), as claimed by the taxpayers.

Section 117(a) of the Internal Revenue Code [2] excludes, among other things, from the definition of "capital assets" property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, depreciable property used in the trade or business, and real property used in the trade or business of the taxpayer.

In 1942 Section 117(j) (Appendix, *infra*) was added to the Code. This provides for special treatment where gains exceed losses from the sale or exchange of certain property used in the trade or business. Such gains are treated as capital gains. This is a relief provision for the benefit of such taxpayers as come within it.

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[2] SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798.] *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), * * * or real property used in the trade or business of the taxpayer;

See *Hazard* v. *Commissioner,* 7 T. C. 372, 376 (Acquiescence, 1946-2 Cum. Bull. 3). However, Section 117(j) expressly excludes property held by the taxpayer primarily for the sale to customers in the ordinary course of his trade or business, and the gains from the sale of property so held are taxable as ordinary income.

It follows that if the Tax Court correctly held in the instant case that the property here involved was held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business then the profits in question cannot be treated as capital gains under either Section 117(a) or (j), and must therefore be treated as ordinary income. We submit that the Tax Court's decision is correct.

The Commissioner made the following determination in the instant case (R. 19, 31-32):

> During the taxable year 1943 you sold thirty-three houses of which three were constructed by you during the last six months of 1942 and the remaining thirty during 1943. Since these transactions were frequent and continuous, it is considered that these houses are properly held for sale to customers in the ordinary course of your business. Accordingly, the profit realized on such sales is taxable as ordinary income.

The Commissioner's determination is presumptively correct and the taxpayer has the burden of proving it to be wrong. *Commissioner* v. *Boeing,* 106 F. 2d 305, 311 (C.A. 9th), certiorari denied, 308 U. S. 619; *Beck* v. *Commissioner,* 179 F. 2d 688 (C.A. 7th); *Welch* v. *Helvering,* 290 U. S. 111, 115. The question whether the property was held primarily for sale to customers in the ordinary course of business is a question of ultimate fact (*Richards* v. *Commissioner,* 81 F. 2d 369, 370 (C.A. 9th); *Greene* v. *Commissioner,* 141 F. 2d

645, 646 (C.A. 5th), certiorari denied, 323 U. S. 717), and the finding of the Tax Court with regard thereto should not be overturned unless clearly erroneous. See Section 1141(a) of the Internal Revenue Code, as amended by Section 36, Act of June 25, 1948, c. 646, 62 Stat. 869; *United States* v. *Gypsum Co.,* 333 U. S. 364, 394-395; *Gillette's Estate* v. *Commissioner,* 182 F. 2d 1010 (C.A. 9th); *Beck* v. *Commissioner, supra.*

With the foregoing principles in mind, we submit that the Tax Court properly sustained the Commissioner's determination in the instant case. The taxpayer not only failed to prove it wrong, but the record clearly shows that it is right.

In its opinion the Tax Court pointed out (R. 35) that taxpayer in his income tax return for 1942 [3] gave his occupation as "Owner, Alpine Planing Mill; Contractor and Builder," and in the same return he stated as follows:

> During 1942 *taxpayer engaged in building homes for sale and on contract.* In addition taxpayer had under construction 53 homes as of December 31, 1942. These homes remained unsold as of close of year. Materials, millwork and sub-contracts capitalized at cost, without taking into consideration usual mark up. Profits on houses built for sale are reported when sold, and it has not been customary to capitalize any anticipated mark up due to increasing values. (Italics supplied.)

The foregoing statements are admissions and they are certainly relevant (cf. *White* v. *Commissioner,* 172 F. 2d 629 (C.A. 5th)); and while as stated by the Tax Court (R. 35-36) the fact that homes were built for sale would not necessarily be controlling if it could

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[3] This return was admitted in evidence as the Commissioner's Exhibit A (R. 54-55) and although not printed it has been transmitted to this Court and by order of this Court filed August 8, 1950, may be referred to in briefs or argument.

be shown that they were converted to rental properties and held primarily for that purpose at the time of sale (cf. *Marks & Co.* v. *Commissioner,* 12 T. C. 1196, Acquiescence, 1949-2 Cum. Bull. 3), still, as also pointed out by the Tax Court (R. 36) the record affirmatively shows that not only were the homes in question built by taxpayer for sale, but he continued to hold them for that purpose.

In this connection the Tax Court pointed out (R. 36):

> In the year involved he sold 33 of the 62 houses constructed during 1942 and 1943. He sold 27 additional homes in 1944 and 4 more in 1945. His profits from sales of homes during 1943 far exceeded his net income from rentals.

And of course the number of houses sold and the profits realized are cogent evidence that the property was held primarily for sale to customers in the ordinary course of business. See *White* v. *Commissioner, supra.* The transactions in the instant case were not casual but frequent and continuous, and the activities of taxpayer were such as to fully support the conclusion that he was in the business of selling the houses. *Commissioner* v. *Boeing, supra,* 106 F. 2d 305, 309; *Ehrman* v. *Commissioner,* 120 F. 2d 607 (C.A. 9th), certiorari denied, 314 U. S. 668. It is not necessary for this to have been his sole business or to have occupied all his time. *Harvey* v. *Commissioner,* 171 F. 2d 952 (C.A. 9th); *Snell* v. *Commissioner,* 97 F. 2d 891 (C.A. 5th).[4]

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[4] The court there said (97 F. 2d at pp. 892-893):

> This taxpayer must, to defeat his claim to a capital gains rate, have been in the business of selling his lands. An occasional sale of land held as an investment is not such a business though profits result. The word, notwithstanding disguise in spelling and pronunciation, means busyness; it implies that one is kept more or less busy, that the activity is an occupation. It need not be one's sole occupation, nor take all his time. It may be only seasonal, and not active

The Tax Court recognized (R. 36-37) that most of the homes in question were rented prior to completion but it also noted that they were rented on oral leases on a month-to-month basis. And in this connection the Tax Court aptly said (R. 36-37):

> Another factor in support of our conclusion is the method used by petitioner in renting the homes in question. As we have pointed out in our findings, most of the homes which petitioner constructed were rented prior to completion. This was due to the shortage of dwellings in this area at the time. It would seem under these conditions that if petitioner had been in the business of renting homes he would have leased them for reasonably long periods of time. Petitioner, however, rented those dwellings on oral leases on a month-to-month basis. Certainly this fact is strong evidence that he wished to keep his property easily available for sale, or, in other words, that he was holding it primarily to sell.

The Tax Court was not unmindful of the regulations of the National Housing Agency which taxpayer relied upon in support of his contention that the property was held primarily for rental. In this connection the Tax Court pointed out (R. 38-39) that assuming that these regulations affected the dwellings in question, the fact remains that during 1943 taxpayer sold 33 homes, or over half of the homes which he built under priorities granted by the National Housing Agency, and that his income from sales of these homes far exceeded his return from rentals. And the Tax Court further observed that the regulations in question expressly provided for sales of housing under certain terms and conditions. It is apparent that these regula-

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the year round. It ordinarily is implied that one's own attention and effort are involved, but the maxim qui facit per alium facit per se applies, and one may carry on a business through agents whom he supervises.

tions are not inconsistent with the conclusion reached by the Tax Court that taxpayer held the property in question primarily for sale to customers in the ordinary course of business, and indeed we note that in the taxpayer's brief filed in this Court it is stated (p. 4) that the dwelling units here involved were sold within the terms of the war-time regulations. And in any event it is submitted for the reasons given above and in the opinion of the Tax Court, that regardless of the provisions of the regulations the evidence justifies the Tax Court's finding that the property in question was in actuality held primarily for sale.

The taxpayer says (Br. 9-10) that Section 117(j) is a relief measure to be construed liberally in favor of taxpayers. It is true that Section 117(j) is a relief provision for the benefit of taxpayers, but it is also true that they have the burden of bringing themselves within its scope (see *Albright* v. *United States,* 173 F. 2d 339, 342 (C.A. 8th)) and there is no basis for any deviation from the established principles, outlined above, that the question whether property was held primarily for sale to customers in the ordinary course of business is one of ultimate fact and the Tax Court's finding in regard thereto should be accepted on appeal unless clearly erroneous. There is nothing to the contrary in the cases cited by taxpayer. Br. 10; *Albright* v. *United States, supra; Hazard* v. *Commissioner, supra, Jamison* v. *Commissioner,* 8 T. C. 173 (Acquiescence, 1947-1 Cum. Bull. 2).

Taxpayer relies heavily (Br. 10, 11) on *Albright* v. *United States, supra.* In that case the taxpayer, a farmer, sold certain livestock culled from his dairy and breeding herds, and the court held, one judge dissenting, that in the circumstances such livestock were not held by the taxpayer primarily for sale to customers in the ordinary course of his business and

therefore the profits should be treated as capital gains and not as ordinary income under Section 117(j). It seems plain that whatever may be thought as to the correctness of the decision in the *Albright* case, still it is distinguishable from the instant one where the evidence fully justifies the Tax Court's conclusion that the homes in question, although rented on a month-to-month basis, were held primarily for sale to customers in the ordinary course of his business.

Taxpayer says (Br. 10-16) that the right to depreciation is of critical importance in determining the applicability of Section 117(j) and that since depreciation was allowable on the homes in the instant case it necessarily follows that they were held primarily for rent and not for sale. We submit that this contention is unsound. It seems plain that the allowance of depreciation deductions under Section 23(1) is entirely consistent with the conclusion that the property was held primarily for sale. Moreover, we see nothing in Section 29.23(1)2 of Treasury Regulations 111, or any of the other authorities cited by taxpayer (Br. 10-16) which is at variance with that view. True, depreciation is only allowed in respect of property used in the trade or business, or in respect of property held for the production of income. But a taxpayer may have more than one business (*Fackler* v. *Commissioner,* 133 F. 2d 509 (C.A. 6th); *Harvey* v. *Commissioner, supra*) and where as here the property was rented, depreciation was allowable even though the renting was essentially temporary and the property was held primarily for sale to customers in the ordinary course of business. Depreciation is generally allowed in respect of rented buildings and this is so without regard to whether they are held primarily for sale. *A. L. Carter Co.* v. *Commissioner,* 143 F. 2d 296 (C.A. 5th); *Black* v.

Commissioner, 45 B.T.A. 204; Bulletin F, Bureau of Internal Revenue (Revised January, 1942), p. 85.

Taxpayer attempts (Br. 17-18) to minimize the significance of the statement in his 1942 tax return (Exhibit A referred to above) to the effect that the homes in question were built for sale, but we submit that such endeavor is unconvincing. Even if the return was prepared by an accountant still the accountant must have drawn on taxpayer for the required information to prepare it and in the circumstances we submit that the Tax Court was justified in concluding that (R. 37)—

> a person of petitioner's apparent business acumen would express his intention with respect to the homes in question to the accountant who made out his returns. At least he did not attempt to explain that statement in the return at the hearing. Certainly there must have been some discussion between him and his accountant concerning the status of these homes.

It can not lightly be presumed that the accountant would make unauthorized statements in taxpayer's return.

Taxpayer criticizes the Tax Court's handling of this case rather severely (R. 18-21), but we submit that there is no adequate basis for such criticism.

In the light of these considerations we submit that the decision of the Tax Court is in all respects correct; taxpayer's objections and criticisms are without merit and there is no reversible error.

CONCLUSION

The decisions of the Tax Court should be affirmed.

Respectfully submitted.

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SEPTEMBER, 1950.

APPENDIX

Internal Revenue Code:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(j) [as added by Sec. 151(b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127 of the Revenue Act of 1943, c. 63, 58 Stat. 21.] *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k)(1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses

from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.117-7 [as amended by T. D. 5394, 1944 Cum. Bull. 274, 276.] *Gains and Losses from Involuntary Conversions and from the Sale or Exchange of Certain Property Used in the Trade or Business.*—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23(1), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the in-

ventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and

* * * * *

shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

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